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**Some Aspects of Comparative Political Research:
The Case of Russian Regions**

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1. Brief outline of the research question and hypotheses.

Introduction

The operational definition to the phenomenon to be explained, namely *market oriented government* is based upon Bruszt, and Weingast's definition of market-enabling state (Bruszt, 2000; Weingast, 1995): the government that is strong enough to maintain rule of law and market order, self-limited, i.e. institutionally constrained in limits that prevent it from engaging into extensive redistribution. In other words, a government, whose policy choices are oriented to reach the equilibrium, when institutional infrastructure makes any extra-market redistributing behaviour on the part of individual actors more costly to pursue than market productive behaviour, is based on reliance on the rule of law. Where good behaviour predominates, the structure of social incentives favours such behaviour, productive efforts are institutionally feasible, and benefits that are produced by such behaviour are properly secured. Actors gain much lower payoffs from redistributional activities than productive ones. Where 'bad' behaviour is widespread, the structure of incentives is such that it encourage individuals to join a majority, since alternatives are few, and unprotected against rampant redistribution.

In practical terms it is a government that develops a powerful judiciary system that allows for impartial enforcement of contracts and property rights, that ensure safe and transparent transfer of ownership rights, government that has a system of safeguards or checks that prevent powerful interest groups from capturing the process of public policymaking, a government that developed all necessary market regulatory mechanisms for input markets to operate smoothly and effectively. The market oriented government provides and maintains institutions that support the creation and effective functioning of input markets, corporate control, and social safety nets.

These differences may be accounted for by the external and internal settings the regional governments find themselves in. The federalational institutional settings created an external market-inducing set of incentives for some of the regional governments, while state-society relations, varying to a significant degree, also created a benevolent environment for market-oriented governmental performance in some of the regions. Hence, the following hypotheses:

Hypothesis 1: those regional governments which gained more bargaining power against the central government during the federation-building process, and were able to extract the conditions of soft budget constraint in fiscal centre-periphery relations were unlikely to be market-oriented in their performance.

On the other hand, social context is not merely milieu out of which it grows, but rather a concrete set of connections that link the state intimately to particular social groups that inherently and unavoidably shape the state institutions. Therefore:

Hypothesis2

The degree of market-orientedness of regional governments depends on the competitiveness of actors/elites and nature of strategies they had chosen. The more competitive elites were, and the less antagonistic and more compromising strategies they exploit, the more market oriented were the behaviour of governments.

I will take regional governments' performance as a **dependent variable** and explore how institutional performance was conditioned by the *soft budget constraints*, which in turn was

determined by the specific path of the federation-building and how *elites' interactions*, by shaping interests and exploring different strategies, facilitate or hinder the efficiency of government performance and whether it induced market-oriented policy choices.

2. De facto regional economic autonomy: how it became possible?

The application of the concept of “*market-orientedness*” to the sub-national, regional governments (RG) invokes several doubts. First of all, is any consideration about a regional political and economic development that does not draw heavily on the influence of federal politics accurate? Empirical evidence demonstrates that due to historical circumstances central politics had relatively weak influence over regional politics¹. Partly this is the consequence of federalism. As Gel'man puts it, ‘there is no evidence of consistency in federal policies toward regions, either nation-wide or toward particular regions’ (1999,9). Political independence of regions grew steadily since the early 90s, when the first ethnic republics claimed their sovereignty status, and became a wide-spread phenomenon after the 1995-1997 gubernatorial elections. Notably, a decentralisation of political authority was not an even process, the degree of independence among regions varied in accordance with their relative bargaining power². All these tendencies have produced a pervasive conviction that regional developments are more subject to regional factors, rather than unifying political pressures from the centre. Some authors even suggest considering the federal authorities as ‘external’ actors, influencing regional politics in a way similar to the international influence on national politics (Gel'man, 1999,9). Without fully supporting this viewpoint, it is clear that the differences in development/underdevelopment of the market institutions in regions to a significant degree are explained by differences in the behaviour of regional governments.

Russian central government adopted the neo-liberal approach to the marketisation of the economy: It was believed that it is enough to minimise state regulation of the economy, and institutions of market would then appear by default. As Polischuk notes, the institutional void, or the absence of robust institutional infrastructure of market not only failed to bring about missing market institutions but resulted in counterproductive, rent-seeking behaviour to become pervasive, and ‘bad’ equilibria to be sustainable (Polischuk, 1998). The liberal market paradigm, implemented on the national level, left the task of implementing market infrastructural institutions to the discretion of regional governments. It was predominantly regional governments that ought to re-regulate and correct the market's failures and provide the institutional environment that enforced protection of universal rights, and granted specific rights to agents. Recent studies on Russian regions recognise regional policies as autonomous by indicating the observation that regional authorities displayed substantial resistance to the liberal economic

1 For extended summary see Valerie Sperling (ed.) Sperling, Valerie (ed.) (2000) *Building the Russian State: Institutional Crisis and the Quest for Democratic Governance*: Westview Press, 2000, , Michael McFaul ‘State Power, Institutional Change, and the Politics of Privatisation in Russia’, *World Politics* 47 (January 1995), 210-43. K. Stoner-Weiss ‘Wither the State? The regional Sources of Russia's post-Soviet Governance Crisis’ Paper prepared for the Annual Meeting of the APSA, Washington, DC, 2000.

2 This pattern finds its parallel in voting behaviour in national as opposed to regional elections. The voting behaviour in the national pools weakly correlates to regional voting behaviour, since regional issues rather than national ones are the most salient factors in voting (Slider, 1997, Solnick, 1998a). To win elections in regions it is important for candidates to express and verify their capability to bring improvements either through lobbying the federal government or introducing reforms that work Berkowitz, 1996, 1994a; Frienkman and Haney 1997), rather than demonstrate the party affiliation. Citizens of some regions can vote for the conservative parties in national elections and at the same time elect governors and administrations that introduce radical market-oriented reforms. Cited in Bradshaw, Michael and Andrey Treivish (2000).

policies (Kirkow, 1998, Hanson and Bradshaw, 2000).

3. Merits of investigating the budgetary relations between the central and sub-national governments. Budgetary federalism, soft budget constraints.

Which level of government has a final say on how money should be spent is extremely important for federation integrity and the stability of federal institutions; moreover, it has a direct effect on the behaviour of the regional governments, generating incentives and creating constraints. Some experts (Lavrov 1997, McAuley, 1997, Gimpelson, Triesman and Monusova, 2000) find budget relations one of the most feasible and accurate ways of measuring and explaining cross-regional disparities. The assumption in their theories that political and fiscal relations are closely connected attracts the most critical attention. Gerrefi & Rodden (2000) hold that the political and fiscal realms may have different sources of development and they may be driven by different processes. They claim that fiscal and political processes of decentralisation of authoritative power and fiscal (re)centralisation may often move in opposite directions³. Yet other authors focus on the explanations of the asymmetry of fiscal relations between centre and provinces and point out the historical conditions when federal government was forced to ensure regional political acquiescence by bailouts to disloyal (Triesman 1998) or economically independent regions (Solnick, 2000b).

However, neither the balance of flows between the levels of government, nor the degree of (de)centralisation of fiscal relations can fully account for the differences in regional government performance. More important are the conditions of hard or soft budget constraints, which a particular region experienced. These political foundations stimulate or dampen the governments' attitude toward reliance on market in their performance⁴.

Weingast's requirement of the hard budget constraints (HBC)⁵ or strict limitation of the revenue-sharing between the levels if the federation is to be market-preserving, has some important limitation for the Russian case. Extreme diversity of the Russian regions makes it virtually impossible to apply this requirement to a full extent; revenue sharing is thus institutionalised in the form of the Federal Fund for Support to Regions (FFSR) supposed to even out the economic and social inequality through equalising transfers. However, Weingast's concept of soft budget constraints (SBC) goes beyond this narrow interpretation: it labels the propensity and capability of the regional governments to remove/ignore obligation to balance revenues and expenditures⁶.

3 Federal centre may devolve formal political authority to sub-units, by increasing their constitutional responsibilities and freedoms, setting up regional parliaments, and allowing direct elections for regional officials, while fiscal authority being concentrated at the federal level. There are several factors, both internal and external, which increase pressures towards fiscal (re)centralisation. For example the decentralisation of fiscal politics may become increasingly costly to the central government to hold a heterogeneous country together.

4 Governments have very weak incentive to improve their performance and develop their economies if their budgets are filled disregard of the level of taxes gathered in the region.

5 Weingast delineates five conditions of market-preserving federalism that include: (i) a hierarchy of governments with a delineated scope of authority (ii) the autonomy of each government is institutionalised in a manner that makes federalism's restrictions self-enforcing, (iii) the national government has authority to provide national public goods, in particular common market, and provide interstate commerce, (iv) all governments have **hard budget constraints**, (v) the subnational government has primary authority over the economy within their jurisdictions: property law, civil law, etc. The condition regarding HBC is not satisfied, and it explains not only why federalism, Russian style, is not market-preserving, but also provides an important analytical clue for understanding the differences in the performance between regional governments.

6 According to Lavrov (1997) in 1996, regional budget revenues had grown by 1,38, while tax revenues - by 1,43,

SBC conditions encompass, therefore, a recurrent pattern of the extra-constitutional revenue-sharing between the levels, and is characterised by governments' stable expectation of the central bailout in case of insolvency⁷.

Albeit the term explicitly points to a budget as a venue where this phenomenon is actualised, other indicators of SBC outside the realm of fiscal flows are also appropriate. Occurrences of bailouts and the rapid growth of regional public employment not corresponding to growth of public responsibilities can be used as measurements of SBC. Qualitative and quantitative analysis of these incidents can be used for this task: first, the existence of federal legal regulation on the procedure for granting tax concession to a given region, second, the existence of the individual concessions established by the decision of the President, third, the existence of the individual concessions established by federal parliament, Duma, and fourth, the percentage of growth of public employment over the growth of the expenditure part of the regional budget.

The next section provides an alternative approach in addressing the differences in governmental performance of Russian regions.

4. Elite interactions in regions. The influence of the interregional enterprises.

The reform of regional political institutions in 1990 fundamentally altered the political process in Russian regions: the first gubernatorial elections succeeded in changing regional leader's political point of reference from Moscow to local constituencies. Though a significant part of chief executives were still Yeltsin appointees, they already perceived the necessity of bestowing their loyalty on their localities.

Stoner-Weiss in her study of Russian regions (1997) claims that the more concentrated the regional economy, the more co-operative were political and economic elites and the higher government performance as a whole⁸. Highly integrated elites, however, are likely to be or become oligarchic (Michels, 1959). Dahl claims that there exists a trade-off between the seemingly contradictory goals of efficiency and stability versus responsiveness. Regimes may not be able to maximise both goals beyond some ideal point before an increase in one results in a decrease in the other (Dahl, 1971). Though elite integration is a desirable equilibrium from the point of view of stable government, this research is not focused on swiftness and smoothness of

the transfers and other revenue sharing between the levels of federation had grown by 1, 57 (Lavrov, 55).

⁷ Hence, the regions that had better chances to win a bargain with the centre on the fiscal issues sought to 'retain control over its own territorial resources even if this means concealing the amount it produces'. On the other hand, those regions that had less bargaining power with the centre and could not pose credible threat in order to fill in their budgets by central transfers, had to look downward and generate more of their own resources.

⁸ She states that because the regional legislatures and executives represented societal interests, instability within and among political institutions reflected broader conflicts among societal actors: pervasive conflict at the societal level gave rise to instability within and between the levels of government. Where the labour, assets and output concentrated in a particular sector of the regional economy, competition for access to political resources was reduced. In this case elite pool was narrowed, and internal allocation of authority was consensual rather than conflictual. As a result there was a consensus and relative stability, leading in turn to higher regional government performance. Concentration of economy had, therefore, a direct effect on the degree of fractionalisation and conflict within legislature, between branches and levels of government. For example, in Nizhnii Novgorod, broader and more coherent economic development plans that included trade initiatives and economic development policies denoted more market-oriented output and effective implementation of government policy-making. Stoner-Weiss stresses the importance of the participation of key organised economic interests in policy formulation and saliency of their authority in the implementation of decision.

the policy process. To explain variance in dependent variable, namely market-orientedness of the RG, the policy content and other aspects of policy decisions that facilitate robust market infrastructure are important. From this point of view, the analysis of speed and efficiency of the policy process will bring little to the research, unlike the study of the interests of the government and influencing actors, capable of putting pressure on government policy decisions. The outcomes of the debate in the elitist literature have an important implication on the argument. One of the requirements of the political stability is at the very least, procedural consensus among elites, or consensus over the 'codes of conduct'⁹. This means 'commitments to the politics of bargaining and compromise ... and willingness to abide by parliamentary and electoral decisions are widely shared norms'¹⁰.

Intuitively, pro-market orientation of the government strongly resonates with the democratic nature of the regional political regime. As Hellman notes, a domination of a highly integrated elite group or a dominant actor, or a symbiosis of the political and economic authority is likely to hinder both marketisation and democratisation developments¹¹. By demonstrating that 'systems with higher level of political participation and competition have been able to adopt and maintain more comprehensive economic reforms than states largely insulated from mass politics and electoral pressures' (Hellman, 1999, 234), he provides substantial evidence important for the hypothesis. Democratic, as well as market oriented behaviour is the result of actors' reliance on formal, rather than informal institutions¹². More generally, the limitation on elites' interactions by formal institutions creates an environment for the rule of law to overcome the influence of informal institutions.

The next argument, inferred from the observation of Russian regions, lines up with Hellman's logic. Gel'man, Ryzhenkov and Brie in their recent book demonstrate that conflict among regional elites created favourable conditions for the development of political parties (Gel'man, Ryzhenkov, Brie, 2000). Gel'man models the political behaviour of regional elites as a particular political regime defined by specific disposition of elites' interaction and character of their strategies. Drawing on the works of O'Donnell (1996), Dahl (1971) and O'Donnell and Schmitter (1986), he distinguishes between the two stages of the process of transition, the transformation *per se* (dismantling of the old system) and the process of the 'outcome of uncertainty'. He claims that the latter, rather than the former determines the ultimate nature of the political regime in a given region¹³. Gel'man's main argument is that the "struggle over the rules" scenario is most

9 Arend Lijphart, *The Politics of Accommodation: Pluralism and Democracy in the Netherlands* (Berkeley: University of California Press, 1968); Robert D. Putnam, *The Comparative Study of Political Elites* (Englewood Cliffs, N.J.: Prentice-Hall, 1976, p.116)

10 Ibid., p.128.

11 This argument contradicts however a widespread conviction of the incompatibility of both planned economy and purely liberal free market economies with democracy. See R. A. Dahl 'why All Democratic Countries Have Mixed Economies' in J.H. Chapman and I. Shapiro (eds.) *Democratic Community* (New York University Press, 1993), 259-282

12 At odds with Stoner-Weiss's argument, it is likely that elite competition, rather than elite consensus that brings about reliance on formal institutions.

13 Here Gel'man supports thesis of Valerie Bunce that in transition both institutions and relative balance of powers are uncertain, that means that there is uncertain position of actors and institution-free environment. Accordingly, breakdown of authoritarian regime does not mean transition to democracy by default, but entry into uncertainty. For democracy to consolidate, as Gel'man states the form and mode of outcome out of uncertainty is important. "Rule of law" scenario is characterised by uncertainty of balance of powers among actors, and danger of the defeat in zero-sum conflict. In this situations actor will opt for regular use of democratic and legal (formal) institutions, because only in this sort of 'weapons' will make them invulnerable. There are four main combination of actors, their strategies and resources, that constitute four scenarios of outcome of uncertainty: 'war of all against all', 'struggle over the rules or

likely to provide institutional settings as a precondition to democratisation, since in conditions of all other scenarios ruling elites attempt to avoid horizontal accountability, and the dominance of informal institutions is likely to result in the power maximisation of the dominant actor(s)¹⁴. Though Gel'man's work is concentrated primarily on the prospects of democratic outcomes on the regional level, his findings are applicable to a broader range of developments.

A similar problem was elaborated to some extent by Weingast (1995) and Solnick (1998a) in their exploitation of game-theory approach. The mechanisms preventing rent-seeking behaviour of the regional elites can be effectively framed into 'transgression' or 'appeasement' game models and addressed in terms of the problem of the sustainability of self-enforcing limits on government. Self-enforcing limits on the government are one of the implications of the 'rule of law' scenario. The problem of policing the state (or sovereign, in his terms) is viewed by Weingast as basically a co-ordination problem. If citizens' beliefs on the boundaries of the state differ to a significant degree, it creates a co-ordination problem, which if not circumvented, leads to unrestrained transgressions on the part of the sovereign. In this context, strict reliance on the formal institutions, or a constitution serves as a co-ordinating mechanism for the political foundations of markets.

As one can comprehend, a multiplicity of actors/citizens, is the first, basic assumption of this game. In our setting it means that there should be more than one actor in the regional political arena. If there is one sovereign, and one citizen (in Weingast's terms), the game immediately transforms into an appeasement game. Second, a particular nature of actors' interaction and character of their strategies is essential: they ought to be co-operative but in a competitive way, so that transgressions of the general law made by a sovereign (making privileges towards one actor), would not be tolerated by other actors. Third, special mechanisms can be employed to bring about this co-operation (constitution, or the adherence to the specific set of formal laws).

The fundamental difference between the two theories lies in the perception and conceptualisation of the formal law. In Weingast's theory it, (a constitution) serves an instrumental function, while in Gel'man's approach the adherence to a rule of law is an outcome most conducive to the consolidation of democratic institutions. Nevertheless, if one considers the meanings of the concepts of the 'rule of law' scenario and the Weingast's 'self-limiting state', both relate to the situation when neither actors, nor the central authority consider the transgression of the established rules more costly than abiding by them.

Both theories are applicable to the study, both lead to the conclusion that the nature of elite interaction inescapably has a significant impact on regional government and policy decisions it makes in the economic sphere¹⁵. The locus of current study is on identifying the forces that drive regional governments to rely on market institutions and incentives that force them to choose

the rule of law', *elite settlement*', or *winner take all*'.

14 This scenario is depicted by multiplicity of actors, as opposed to the dominance of a single actor in 'winner takes all' and 'elite settlement' scenario; and the regular use of *formal* institutions as 'weapons' in elite struggle, as opposed to use of utilisation of force strategies and informal institutions, in 'war all against all' scenario.

15 In Russian case it was often the case that theregional elites were both part of the government (insiders) or different agencies, influencing governmental decisions from outside (outsiders). For the purposes of research, it does not make difference, since the the most impotrtant implication of these theories is not the dichotomy between the sovereign and the actors, but the multiplicity of the actors (sub-national governemtns in Weingast's theory that support federalational settings), and inter-regional actors in Gel'man's theory, and second, the presence of the formal law that being abide, facilitate co-opertion.

strategies that aim at reinforcing markets in their localities. Bearing in mind theoretical arguments put forward by Gel'man, Weingast, and Solnick outlined above, it can be argued that 'struggle over the rules' outcome of uncertainty has the highest likelihood to impede the rent-seeking inclinations of actors and create a market oriented and responsive government, since this scenario best suited to provide an institutional framework for horizontal accountability via institutional limitations on the assertions of authority¹⁶.

In the present research, however, two main modifications are made:

1. More stress is placed on the nature of elite interaction presuming that the special mechanism that brings co-operation of actors is not in place and cannot easily be brought to play. In these circumstances, the best strategy assumed by the actors is to capture the state. The rule of law, being weak, cannot guarantee that these transgressions will be curbed by virtue of the authority of the state. These transgressions could, in fact, be confronted only by another elite group, within or outside of the regional government. In this respect, my vision of the 'rule of law' is closer to Gel'man's.
2. There is still a big gap between the adherence of political elites to the formal institutions and self-limitation of the regional government, on the one hand and the market-orientedness of the regional government, on the other. The government has to be constrained both from inside/below and from above, to opt for productive versus re-distributional behaviour. Only linking this theory with the above outlined and accounting for the presence of the interregionals, more sound inference can be drawn.

Intervening variables: interregional enterprises/elites

Russian economic transition created a situation of partially installed market institutions, which was exploited by powerful economic actors for their personal gain. Price liberalisation without simultaneous anti-monopoly regulation and regulations securing free entry to market provoked many monopolist producers to raise prices beyond reasonable limits and gain immense monopoly rents. At the same time, inputs for some types of production were still heavily subsidised by the state, securing them low production cost. This remnant of the old system, combined with liberated prices and free foreign trade, gave the producers an opportunity to profit on this duality: costs of production were not market-driven, while sales were made according to world market prices.

As Hellman (1998) persuasively argues, not only the losers from the transition to a market economy had incentives for development of a liberal market. More often than not, winners' behaviour constituted a serious obstacle for the entrenching of market institutions. Those who gained significantly during the first years of privatisation, liberalisation of prices and foreign trade, put all their effort into weakening the viability of the state, its legal system and institutional infrastructure supporting market.

Hellman states that the managers and owners of the large financial-industrial conglomerates, emerging from the privatisation process and especially after the loans-for-shares auctions (1995,) had interests at odds with the interests of market-oriented actors (Hellman 1998, 233). They view

¹⁶ This argument is also reflected in recent critique on the Weingast's theory of market-preserving federalism. As Rodden and Rose Ackerman argue, if regional elites' personal interests for enrichment prevails over their commitments to regional societal interests, federalism can not be market-preserving (1997). Federalism in this case facilitates creation of distributional coalitions and/or strengthen existing ones. The important question is what are the conditions of elites' insulation from the rest of society in pursuit of personal goals, and whether competition of elites or elites' integration is enabling this tendency.

the development of market institutions as detrimental for their privileged position and an impediment for their activities¹⁷.

In the first years of transformation the private economic actors independent from the state had no real political weight, political authority was still vested in organisations inherited from the past and their leaders. A significant part of these organisations represented the bureaucratic apparatus of the branch ministries. Their interests were tightly connected with the survival of the old structures, vertical and horizontal production networks of the previous regime. Nevertheless, with the dissolution of the branch ministries, these ties started to lose significance, and eventually ceased to exist, with the exception of the natural gas and energy industries that succeeded in transforming themselves into the nation-wide companies Gazprom and EES Rossii. Starting from 1994, a new type of economic structure started to gain political and economic prominence. With the end of voucher privatisation, the auctioning of the most important companies started, and during 1994, the first six FIGs were registered. During the next two years 103 new FIGs emerged, concurrently with the establishment of a large number of holding companies and business conglomerates (Schroder H.H., 1999, 963). The first part of these new structures (FIGs, holdings) evolved around a financial core. The explanation is that in the years of hyperinflation (1992-1995) the operations with foreign currencies and short-to-medium term credits were a great deal more profitable than investment into the real sector. Even with the curbing of inflation, commercial or state banks could use state funds passing through their accounts as short-term zero-interest credits. A prudent decision for a manager of a production company therefore, was to include a financial institution into the structure of the holding, so as not to let go of the additional profit gained in the financial sphere.

The second part of the new conglomerates has a production enterprise as the centre of amalgamation. New oligarchs generally are entrepreneurs of large enterprises operating in oil and gas sector, telecommunications and energy sector¹⁸. Additionally to the above mentioned sectors, metallurgical conglomerates obtained a leading position in many regions: Rossiiskii Alyumini, Noril'skii Nikel, Severstal', and other. With the formation and solidifying of these structures, the actors, who previously profited from state policies (subsidisation, privatisation, partial liberalisation, etc.) attained independence from them. There is little doubt that chief managers and owners of these enterprises have an immense influence on the performance of government, both on federal and regional level. In the presented paper I will focus on the impact of the interregional elites on the decision making of the regional governments. The Table 1 in Appendix presents the share of the large interregional enterprises (IR) in the regional industrial production.

Close examination reveals that the influence of the IR on the performance of the RG is rather ambiguous. Lapina N., Chirikova A. (1999, 83-102) categorise the interaction of the IR and the RG into four different scenarios: 'patronage', 'partnership', 'war all against all', and 'capture of the state', which labels speak for themselves. This categorisation gives rather one-dimensional estimation of the balance of powers between the RG and IR. Zubarevich (2002) carried out a more complex and elaborated analysis of the regional governments' behaviour based on cross-regional comparisons, conceptualising it in terms of the closeness-openness of the region. RG's

17 While talking about financial-industrial conglomerates Hellman has in mind primarily financial industrial groups (FIGs), which emerged in 1994 and were active during 1994-1999 years, their activities gradually declined or were transformed after October crisis 1998.

18 Bankers who remained in the list of tycoons, similarly to the managers of the large production enterprises, derived their influence from the ownership of large shares of big, profitable and usually territorially and functionally expanded conglomerates.

aims, according to her viewpoint, are somewhat contradictory and are closely linked to the prevailing economic tendency, which is defined in terms of closeness-openness. The closeness-openness of the region, in turn, is an outcome of different factors, the presence of interregional enterprises and the pro-market interests of their leaders and managers being the critical features. Therefore it is considerably late to accept Hellman's argument that they, as major winners of transition, will invariably confront the consolidation of market institutions.

5. Preliminary design for the test of the hypothesis.

In the section below I present an outcome of the statistical processing of the data, using MIM software program. The major part of the section is devoted to the explanation of the methodology of obtaining and evaluating the necessary data and specific problems connected to it.

The rule of causal inference requires identification of the puzzle to be explained across the observations, the construction of an indicator that will estimate it, and determination of the set of the features of social and political institutions that co-vary with it. The latter is believed to plausibly represent the causal mechanisms that account for differences in the dependent variable. Sticking to this basic rule, the research design will consist of two parts, (i) justification for the measurement procedure of the dependent and independent variables, (ii) statistical evaluation of hypotheses put forward to explain the variation on regional governmental performance.

Measurement of Dependent Variable

The concept of the 'market orientedness' of the regional government is considerably complex, encompassing such notions as a state of mind of governors, an attitude, interests, which are then translated by multiply measures/policy decisions affecting market infrastructure in the region. The operationalisation of this concept involves no small difficulty, apparently, no single criterion can fully reflect it. It shows a clear need to construct a composite variable based on observable variables that correspond to this concept and operationalise the theoretical hypothesis in terms of these variables. Focusing primarily on policy decisions of the RGs, I suggest to construct a composite index, reflecting *:

1. existence of the normative regulations on protection of small business;
2. existence of the regulations of the market infrastructure institutions;
3. index of growing entrepreneurialism: the number of the new enterprises (*de-facto* operated) adjusted to the average size of the enterprises;
4. existence of prohibition on export of production to other regions;
5. existence of normative acts providing for the control of prices on the territory of the region, either in operation or suspended after protest by the procuracy;
6. existence of the normative requirements for agreement of prices with RG;
7. Restrictions on trade margins or profit rates.

Additionally, fiscal indicators, being feasible and ready at hand, can justifiably be used for measurement, particularly, the indicators of the expenditure part, since the policy decision of the regional government is clearly visible in the patterns of expenditure:

8. Share of the industrial or agricultural subsidies to regional producers in the expenditure part of the regional budget.

*The items 4-8 enter the index with negative sign.

Following the above-mentioned method it is possible to arrive at relatively accurate index of market-orientedness, though adherence to this method will require thorough data-collection procedure, which is time and effort consuming. The way to circumvent the problem is to utilise the available data and recast a research question to produce another variable, useful for the study: the ranking of regions in the order of their market-orientedness. This procedure involves experts' evaluations and is presented in the sub-section below.

Experts' evaluations

To operationalise and measure the dependent variable, experts' evaluations can be used as well. One of such indices is "investment attractiveness" of the regions - one of the most systematically collected and reliable indices pooled over a significant period of time and covering all the regions of Russia. It is a composite index that reflects structurally the economic and political environment in each region, some components of which can be considered as relevant estimators of the development of market institutions in a region, and through this, of regional governmental performance¹⁹. The 'development of market institutions' variable is a part of the index of investment potential of the region, which in turn is one of the two main components of the index of regional investment attractiveness. Since the indicator of 'development of market institutions' reflects the presence or absence of formal institutions of market economy, adding to this variable the evaluation of risk level (legislative, economic and financial risk) will allow for more precise estimation of regional governmental performance²⁰. The outcome of calculations is presented in Appendix, Table 2, where the number allotted to a region negatively corresponds to the market-orientedness: the higher the value of the variable, the less market oriented is a regional government.

Measurement of Independent Variables

Measurement of SBC

The analysis of the fiscal flows in the Russian case, together with the indicators outlined in the section 3 (p.5), can disclose some tendencies and point to clues that are useful for the task of measurement of the SBC. The following analysis indicates some additional estimation potentially useful for the research.

1. The first observable indicator is whether a regional budget is deficient: regions that due to several reasons, secured themselves SBC conditions, usually run a significant *budgetary deficit*. Not only was this the result of the lack of effort to make ends meet, but often this was an intentional purpose on the part of regional governments. The soft budget constraints create incentives for regional governments to not avoid, but seek budgetary deficit, so that the undeniable reasons for applying for prolongation of SBC conditions are securely in place. However, budget deficit solely can not be used as an indicator of SBC, since structural factors are seriously confounding the measurement.

2. The second possible measure of the SBC is the *balance of budgetary flows*. According to this (tax remittance to the federal budget minus federal subventions, transfers, and loans) net

19 As was shown above, the degree of stability and maturity of market institutions on regional level was a function of many factors, but the governmental performance being the crucial one.

20 Since the estimators of the level of risk are obtained through observations and evaluations of degree of implementation of basic regional legislative base and other variables directly dependent on actions of regional governments, the indicator of 'development of market institutions' will be closer to the concept it represent.

recipients and net donors of the federal budget can be distinguished. This straightforward dichotomy, however does not yield a one-to-one dichotomy between regions experiencing soft or hard budget constraints. Several factors can be confounding, first and foremost, the structural differences between the regions stemming from economic centralisation and misfortunate geographical factors. Russian GDP is produced in a minority of regions: according to Goskomstat, the top ten regions in 2001 produced about 42 percent of the country's total GDP²¹. On the other hand, a number of regions are small, remote, backward in economic terms and dramatically lack human capital to pursue independent economic and fiscal policy. Regions vary enormously with respect to development of their industrial base, modernity, and living standards. In the foreseeable future, a majority of poor regions, such as Ingushetia, Dagestan, Tyva, Koryaksky, Chukotsky, Aginsky-Buryatsky okrugs etc. cannot cease to be region-recipients of the federal budget, whatever stance towards marketisation their governments adopt. Yet, apart from the economic diversity, regions in Russia diverge in terms of the policies their government have adopted to deal with the consequences of economic crisis. Observations show that the patterns of economic development/backwardness have not duplicated in patterns of market-supporting/opposing governmental behaviour. This observation calls for the query of other SBC measures that are responsible for suppressing market-orientedness.

3. Taxes are composed of two main categories, first those whose revenues are allocated to one level of government, and those whose revenues are shared between the federal and regional governments. The division of revenues in the latter category is regulated by pertaining laws, but the actual division differed significantly from what is prescribed by law. Analysis of such disparities can yield useful insights into the nature of centre-periphery fiscal relations in general, and SBC conditions in particular²². For example, comparative analysis of the *share of the regional taxes in total tax collections* helps to detect the regions that were capable on forcing the federal centre to sign fiscal arrangements entitling them to retain larger tax shares (up to 100%), in contradiction to the general regulations.

However, this estimation is also not free from the influence of confounding factors. The first alternative explanation is that arrears on the shared taxes had grown faster to the federal level due to the fact that regional governments had a possibility to attain their share of receipts via mutual offsets with regional enterprises, while federal government had not. Second, according to the regulation concerning the functions of the Federal Fund for Support of the Regions (FFSR), the federal share of receipt on VAT was, in several cases, allowed to stay in region as an offset to an equalisation transfer.

4. During 1995-1998, macroeconomic policies of the central government aimed at reducing hyperinflation led to enormous payment arrears and pervasive non-monetary payments. This situation forced regional governments to run tax arrears, both to regional and federal levels. Nevertheless patterns of distribution of these arrears were deviant: economically backward regions usually run less arrears to federal than to regional level or equally. Being a major recipient of the federal budget they depended on federal government to a significant degree. Therefore, as net beneficiaries of the central re-distributive programs they were better off paying their taxes to the federal budget without arrears, and lobbying for larger transfers.

21 Goskomstat Rossii: Rossiiskii statisticheskii yezhegodnik 2001, Moscow: 2002, pp.20-21

22 Only in 1996 more than 100 extra-constitutional fiscal documents signed toward such regions as Tul'skaya obl., Buryatia, Sakha, Dagestan, Komi, Kareliya, Kabardino-Balkaria, Tyva, Udmurtia, Kalmykiya, Karachaevo-Cherkessia, Tymenskaya and Kaliningradskaya obl., Kemerovskaya, Samarskaya obl., and Primorsky krai. Lavrov.

More successful regions can finance their budgets without federal loans and transfers, and their strategy was different with respect to arrears: running tax arrears to the federal budget reduced their contribution to federal programs²³. This pattern is clearly visible in the *share of the accumulated debt to the federal budget in total tax debt*. While this observation has little in connection to SBC²⁴, it constitute an important component that will be used in liaison with other indicators.

In order to elaborate a valid measure of the SBC, it seems practical to combine several indicators of budgetary relationships. Balance of budgetary flows as a percentage of the expenditure part multiplied by the percentage of the regional taxes in total tax collections, and share of the accumulated debt to the federal budget in total tax debt divided by 100 produces the composite index of the SBC (See Table 3 in Appendix). A test of these indicators showed that three variables taken separately display a lower level of correspondence with the dependent variable relatively to the composite index.

Elite Interaction Model

In order to group regions into four outlined categories, it is necessary to conduct a specially-designed survey study, incorporating evaluation of the level of competitiveness of elites, nature of elite's conflicts, and typical ways of their resolution. For a preliminary test of the hypotheses it is possible, nevertheless, to utilise available data on gubernatorial elections. I allotted dummy variables to the outcome of the 1996-1997 gubernatorial elections, so that "0" corresponds to low level of contest (0-5 % votes to the second candidate, or appointment), "1" – low-medium level of contest (5-10% votes for the second candidate), "2" – medium level of contest (10-20%), "3" – high level of contest (20-30%), and "4" – to highly contested elections where second candidate received more than 30% of votes, see Appendix, table 4.

Presence of intergovernmental elites

The presence of intergovernmental enterprises/elites in the region is also not a readily observable variable. For the preliminary test of the hypothesis I calculated the share of the 20 largest companies²⁵ in Russia, which are interregional in character, in the total regional industrial production, the outcome of which is presented in Appendix, Table 1.

Preliminary test of the hypothesis

The preliminary test of the hypothesis was carried out in the form of a multivariate statistical analysis using the software MIM program (see Appendix Table 3).

23 Tax remittance patterns were used elsewhere as an estimation of the relative political and economic resourcefulness of the regional government. Zubarevich, for example states that the more independent is the region/governor, has more incentives to remit less tax to the centre, and leave more tax in the region. See <http://pubs.carnegie.ru/>

24 Except of the several cases, described in Lapina N. and Chirikova A. *Regional'nye elity v RF: modeli povedeniya i politicheskie orientacii*: RAN INION, Moscow, 1999, when regional governments explicitly or implicitly encouraged regional enterprises to pay the regional taxes first, and only after, federal taxes. This phenomenon arrested though the above mentioned variable in these cases can justifiably be used as an indicator of SBC, as well as a positive balance of power of the regional government vs. federal.

25 As estimated by Expert magazine. See <http://eng.expert.ru/expert/>

Before proceeding with a description of the test outcomes it is worthwhile reflecting on some possible arguments refuting the relevance of the market-orientedness as a dependent variable and feasibility of its separate evaluation. Indeed, there might be a significant variation across the spectrum of intervening factors that can cause the observed correlation to turn spurious, and prove conditional independence of these variables given the third one. For example, ostensibly, the first independent variable can be viewed as a derivative of the relative economic strength of the region. Structural explanations such as the endowments of regions with natural resources, and/or advanced industrial base, and/or strong link with multinationals can serve as primary factors that predetermine the development of the markets at the regional level. At first glance this straightforward explanation seems to be quite compelling. The research conducted by Hanson and Bradshaw (2000) show that the market and democratic development were the outcome of structural factors, and the contemporary ongoing polarisation of the regions was used as a proof of the thesis. However, in my view, to understand the complexity of the systemic economic developments in the regions, and assess the future prospect of the development of market institutions, a government's behaviour has to be conceptualised *separately* from its possible product. Therefore, in the present research I stepped one link back in the causal chain: the policy decisions of the regional governments that promote/impede development of market institutions I held as an ultimate dependent variable, which makes the whole project maybe less ambitious, but far more feasible.

As the final result shows, the test demonstrates a strong association between the soft budget constraint condition and the market-orientedness of the regional governments. Besides, the dependent variable is closely correlated to the level of privatisation of small and medium enterprises, which was an expected outcome, given that the privatisation programme was elaborated along provincial divisions, which led to 'localisation' of privatisation authority²⁶ and was directly influenced by the regional governments. There are also statistically meaningful negative associations between the variables of presence of interregionals and soft budget constraints; the presence of interregionals and share for the value of fixed priced production and services in total value of production and services; the positive association of competitiveness of elections and privatisation level. Therefore, the statistical outcome is consistent with the hunch of the positive influence of the interregional enterprises on the behaviour of the regional governments.

To summarise, with some confidence it can be stated that a market-oriented governmental behaviour was predetermined by the fiscal relationships: governments experiencing the SBC conditions were unlikely to be market-oriented. The test also ascertains the intervening character of the variable of interregionals. Nonetheless, the test does not confirm the second hypothesis: an electoral competitiveness and a market-orientedness appear to be conditionally independent. This result calls for further analysis aimed at increasing the validity of the measurement of the second independent variable. For example, the inclusion of the status of the incumbent (whether or not he/she was contested in elections, and whether he/she won) into the measurement would increase its comprehensiveness²⁷.

26 This term was put forward by Radygin (1994, 71), who is considered to be one of the main experts and theoretical authorities in the field of Russian privatisation

27 Alfred Stepan uses a similar procedure for the measurement of competitiveness of elections: he uses dummy variable rating competitiveness 'high' if incumbent participated and was defeated, and 'low' if incumbent won with more than 85% of votes or was appointed. See Stepan A. (2000) „Russian Federalism in Comparative Prospective”, *Post-Soviet Affairs*, 2000, 16, 2,

Nevertheless none of these conclusions can be approached with confidence until they are replicated with the data collected in a series of observations. Moreover, with the sharpening of the measurement tools and enhancing the validity of the measurements, the observed relationships can be ascertained and hypotheses proved valid.

6. Concluding remarks

Any conclusions offered here need to be moderated by the methodological limitations of analysis: first and foremost, the data processed in the course of the analysis have relatively low information content. However, the outcomes of the statistical test are consistent with hypotheses. The presented results call for several lines of improvement, including those connected to:

1. The measurement of the SBC: budgetary flows solely can not be used as comprehensive indicators of the redistribution of resources between the levels of the government. Extra-budgetary flows and redistribution of property rights has to be taken additionally into account in order to gain a fair picture of the relationships between the centre and periphery.
2. Elite interaction measurement: the presented research lacks significant data on the base of which one can construct reliable models. Competitiveness of elites measured in a suggested way affords only a very approximate and rough measure of the elite's interaction.
3. A separate consideration of the interregional elites can be an object of criticism: IR, considered in terms of managerial corpus, can not be distinguished from the second independent variable, elite interaction model. Indeed, the presence of a powerful IR, by providing an additional node to the scheme of elite interactions, decrease the probability of the dominance of a single actor, and this automatically set grounds for elite interaction to assume more competitive character than would be otherwise. To tackle this argument, first, the principal difference between the IR authorities and regional powerful actors has to be stressed: they are often outsiders with respect to the regional elite. This detail influences the interests, aims, and resources of these actors that make them distinct from regional actors. Second, it will suffice to highlight the distinction between the interregional and the regional companies, which acquired international links. Third, there is a need in explanation how exactly the presence of a IR on the territory of the region alters the balance of powers among elite. And forth, how the economic structure and vertical networks contribute to the incentives of the regional government as a whole. Therefore, the presence of the interregionals can be viewed as a as a separate intervening variable, influencing other independent variables.

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